

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
	:	
of	:	
	:	DETERMINATION
TRADEARBED, INC.	:	
	:	
for Redetermination of a Deficiency or for	:	
Refund of Corporation Franchise Tax under	:	
Article 9-A of the Tax Law for the Years	:	
1977 through 1981.	:	

Petitioner, Tradearbed, Inc., 825 Third Avenue, New York, New York 10022, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1977 through 1981 (File No. 65109).

A hearing was held at the offices of the State Tax Commission, Two World Trade Center, New York, New York on March 10, 1987 at 9:30 A.M. Petitioner appeared by Murphy, Hauser, O'Connor & Quinn, Esqs. (William J. McCann, Esq. of counsel). The Audit Division appeared by John P. Dugan, Esq. (Michael J. Glannon, Esq. of counsel).

ISSUE

Whether the Audit Division, in revising petitioner's business allocation percentages, properly recalculated the receipts factor on the basis that petitioner was a selling agent of its parent corporation.

FINDINGS OF FACT

1. Petitioner, Tradearbed, Inc., (denominated "TradeARBED" on its invoices and elsewhere) filed corporation franchise tax reports for the years 1977 through 1981, showing entire net income and business allocation percentages as follows:

<u>YEAR</u>	<u>NET INCOME</u>	<u>BUSINESS ALLOCATION PERCENTAGE</u>
1977	\$1,321,518.00	41.91994
1978	938,923.00	26.594
1979	1,385,641.00	28.889

1980	780,499.00 ¹	32.394
1981	429,893.00	33.158

On August 19, 1985, the Audit Division issued five notices of deficiency to petitioner, asserting corporation franchise tax plus interest as follows:

<u>PERIOD ENDED</u>	<u>TAX</u>	<u>INTEREST</u>
December 31, 1977	\$74,372.00	\$75,922.00
December 31, 1978	47,811.00	43,718.00
December 31, 1979	69,313.00	56,001.00
December 31, 1980	18,776.00	13,171.00
December 31, 1981	59,462.00	31,653.00

3. Petitioner was an importer of steel products for resale to customers throughout the United States. Its principal office was in New York City. During the audit period, petitioner was owned by two related European companies, Tradearbed, S. A. and Tradearbed Participants, which were owned in turn by Arbed, Inc. Petitioner bought and sold structural steel, merchant bars for warehouses and steel coils for industry. It purchased the majority of these products from its related companies which owned and operated steel mills in Belgium and Luxembourg.

4. The asserted deficiencies resulted from a field audit and a consequent recalculation of petitioner's business allocation formula. Petitioner calculated its business receipts factor by including, among other relevant factors, "sales of tangible personal property" (which were made primarily outside of New York State) and "services performed" (which were performed primarily inside New York State). The Audit Division determined that petitioner was, in fact, a selling agent of its affiliated corporations, and as such it had no sales of tangible personal property of its own. Accordingly, the Audit Division recalculated petitioner's business receipts factor by entirely omitting gross sales from the computation. This resulted in business receipts factors of 95.0575 percent in 1977; 97.5239 percent in 1978; and 100 percent in 1979, 1980 and 1981.

5. With gross sales omitted from the calculation, petitioner's primary source of business receipts, as shown on its tax reports, was "services performed". The same amounts were referred

¹Petitioner subsequently filed an amended return and reported an entire net income of \$27,749.00.

to on petitioner's financial statements as "Commissions". The fact that petitioner received commission income was a major factor in the Audit Division's determination that petitioner was a selling agent. Other factors were petitioner's practice of maintaining little or no inventory and petitioner's extremely low profit margin, slightly more than one percent. The Audit Division considered the low profit margin to be an indication that petitioner's net income resulted from sales commissions rather than sales of tangible property. The following chart illustrates the importance of petitioner's commission income for its overall profits:

<u>YEAR</u>	<u>GROSS PROFITS</u> <u>FROM SALES</u>	<u>COMMISSIONS</u>	<u>NET INCOME</u>
1977	\$ 848,511.00	\$1,321,518.00	
1978	1,219,098.00	1,446,664.00	
1979	2,137,864.00	1,590,571.00	
1980	2,150,384.00	1,346,142.00	
1981	2,381,216.00	1,757,870.00	
	938,923.00		
	1,385,641.00		
	780,499.00		
	429,893.00		

6. Petitioner's accountant testified that the term "commission", as used by petitioner during the years at issue, actually denoted mill discounts on purchases petitioner made from its suppliers. Invoices established that petitioner received such discounts ranging from 1 to 2.5 percent from both affiliated and unaffiliated steel mills².

7. Petitioner's customers were steel fabricators, who bought specific sizes for specific jobs in construction or industry, and steel distributors, who stocked standard length steel for resale. The vast majority of petitioner's purchases were made for specific customers. Petitioner's sales personnel solicited orders and then petitioner negotiated with its supplier steel mills for price and

²A discount of 1.5 percent on purchases from affiliated steel mills, as shown by petitioner, was the result of an agreement between petitioner and the Internal Revenue Service regarding product pricing stemming from an I.R.S. audit of petitioner several years prior to those in issue (presumably made as an I.R.C. § 482 intercompany adjustment to reallocate intercompany pricing to an "arm's length" basis).

availability of goods. All of petitioner's contracts of sale with its customers provided: "THIS ORDER IS SUBJECT TO OUR MILL'S FINAL ACCEPTANCE". Thus, the customer was aware that it had no contract with petitioner until petitioner's mill accepted the order by agreeing to produce the final product. Petitioner's vice-president testified that petitioner places, at present, approximately 60 percent of its orders with affiliated mills and the remainder with unaffiliated mills. No documentary evidence was submitted to substantiate this estimate, nor was any specific evidence provided by petitioner as to purchases from affiliated versus unaffiliated mills during the years in question. By contrast, the auditor testified he was advised, during the audit, that 85 percent of petitioner's purchases were from affiliated mills.

8. Petitioner generally purchased steel on a C.I.F. (cost, insurance and freight) basis. In essence, petitioner assumed title and ownership risks when the steel was loaded for shipment. It could, and sometimes did, simultaneously invoice its own customers on the same C.I.F. basis.

9. Petitioner maintained independent credit with several domestic banks to finance its accounts receivable; it absorbed all losses from unpaid accounts, damaged merchandise, and merchandise which failed to meet the customer's specifications; and it operated an independent credit department which approved or disapproved credit to customers. Inventory maintained by petitioner usually resulted from either cancellation of an order or the withholding of credit to a customer.

10. Petitioner maintained its own claims unit. If a customer's claim of defective or damaged merchandise was determined to be a shipping claim, petitioner instituted insurance recovery procedures. If the claim was determined to be a "mill claim", petitioner instituted procedures against the mill. Where mill claims were rejected, petitioner sustained the loss.

CONCLUSIONS OF LAW

A. That Tax Law § 210.3 provides for the allocation of a portion of a taxpayer's entire net income to New York on the basis of a formula consisting of three factors (expressed in percentages): the taxpayer's real and tangible personal property, business receipts and payroll.

The percentages of these three factors result from fractions, the numerator of which is the property, receipts or payroll within New York and the denominator of which is all property, all receipts or all payroll of the taxpayer. The receipts factor is weighted twice. The four resulting percentages are totalled and divided by four to arrive at the taxpayer's business allocation percentage (20 NYCRR 4-2.2).

B. That 20 NYCRR 4-4.3(b) provides as follows:

"Commissions received by a taxpayer are allocated to New York State if the services for which the commissions were paid were performed in New York State. If the services for which the commissions were paid were performed for the taxpayer by salesmen attached to or working out of a New York State office of the taxpayer, the services will be deemed to have been performed in New York State."

C. That the Audit Division's determination that petitioner had no sales of tangible personal property did not rest solely on its finding that petitioner acted as a sales agent for its related corporations. Additional factors relied on by the Audit Division were that: (i) the difference between cost of goods sold and petitioner's gross sales was only slightly over one percent, and thus sales alone were inadequate to earn profits for the corporation; (ii) petitioner maintained little or no inventory; (iii) purchases made by petitioner were for the account of a specified customer and were produced according to that customer's specifications; (iv) petitioner's contracts of sale provided that the customer's order was "subject to our mill's final acceptance"; (v) payments received were designated "commissions"; and (vi) the majority of petitioner's purchases were from affiliated mills. By contrast, petitioner asserts several factors militate against the Audit Division's position, including that: (i) petitioner could not bind either related or unrelated steel mills in contract; (ii) petitioner financed its own receivables and bore losses from bad debts; (iii) petitioner took title to the goods when the mills placed the goods with a carrier for shipment; and (iv) petitioner took rejected orders into inventory bearing any losses (or shortfalls in compensation on claims) in connection therewith.

D. That based on all of the evidence presented, the Audit Division's conclusion that

petitioner was a selling arm or agent of its affiliated corporations during the years at issue was reasonable and is sustained. The facts herein are strikingly similar to those found in the State Tax Commission's decision on this very issue for this same taxpayer for prior periods (Matter of Tradeared, State Tax Commn., May 27, 1983), and departure from the result arrived at therein is not warranted. Finally, based on the evidence presented, it is not possible to determine if petitioner's receipts may be appropriately apportioned between amounts ("commissions") from affiliated mills and amounts relating to sales of products purchased from unaffiliated mills.

E. That the petition of Tradeared, Inc. is hereby denied, and the five notices of deficiency issued on August 19, 1985 are sustained.

DATED: Albany, New York
September 24, 1987

ADMINISTRATIVE LAW JUDGE